71-1378

Supreme Court, U. S.
FILED
APR 25 1972
MICHAEL RODAK, JR., CLERK

FILE COPY

IN THE

Supreme Court of the United States

October Term, 1971

No.

INTERCONTINENTAL INDUSTRIES, INC.,

Petitioner,

versus

AMERICAN STOCK EXCHANGE and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BERNARD A. FEUERSTEIN,
Attorney for Petitioner,
250 Park Avenue,
New York, New York 10017.
(212) 867-6062

Of Counsel:
NATHAN M. FUCHS
IRWIN P. UNDERWEISER

TABLE OF CONTENTS

	PAGE
Petition	1
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Constitutional Provision	2
Introductory Statement	2
Statement	3
Reasons for Granting the Writ	8
Conclusion	20
Appendix A—Opinion of the Court of Appeals	A1
Appendix B—Opinion and Order of the Securities and Exchange Commission	B1

Authorities

Cases:

Armstrong v. Manzo, 380 U. S. 545, 85 S. Ct. 1187, 14 L. Ed. 2d 62 (1965)	15
Bell v. Burson, 402 U. S. 535, 91 S. Ct. 1586, 29 L. Ed. 2d 90 (1971)	9
Belton v. Hatch, 109 N. Y. 593, 17 N. E. 225 (1885)	8

PAGE

Coe v. Armour Fertilizer Works, 237 U. S. 413, 35 S. Ct. 625, 9 L. Ed. 559 (1914) 15

Escalera v. New York City Housing Authority, 425 F. 2d 853 (2d Cir. 1970) 17

F. T. C. v. Cinderella Career and Finishing Schools, Inc., 404 F. 2d 1308 (D. C. Cir. 1968) 18

Goldberg v. Kelly, 397 U. S. 254, 90 S. Ct. 1011, 25 L. Ed. 2d 287 (1970) 9

Greene v. McElroy, 360 U. S. 474, 79 S. Ct. 1400, 3 L. Ed. 2d 1377 (1959) 14, 16

Jennings v. Mahoney, 404 U. S. 25, 92 S. Ct. 180, 30 L. Ed. 2d 146 (1971) 17

Lee v. Habib, 424 F. 2d 891 (D. C. Cir. 1970) 13

Mullane v. Central Hanover Bank & Trust Co., 339 U. S. 306, 70 S. Ct. 652, 94 L. Ed. 2d 865 (1950) 19

Sherbert v. Verner, 374 U. S. 398, 83 S. Ct. 1790, 10 L. Ed 2d 965 (1963) 9

Silver v. New York Stock Exchange, 373 U. S. 341, 83 S. Ct. 1246, 10 L. Ed. 2d 389 (1963) 8, 12

Slochower v. Board of Higher Education, 350 U. S. 551, 76 S. Ct. 637, 100 L. Ed. 2d 692 (1956) ... 9

Speiser v. Randall, 357 U. S. 513, 78 S. Ct. 1332, 2 L. Ed. 2d 1460 (1958) 9

Wasson v. Trowbridge, 382 F. 2d 807 (2d Cir. 1967) 19

PAGE

STATUTES:

Constitution of the United States
Fifth Amendment 2

Securities Act of 1933

Section 17, 15 U. S. C. §77q(a) 4

Securities Exchange Act of 1934

Section 6(a), 15 U. S. C. §78f(d) 8
Section 10(b), 15 U. S. C. §78j(b) 4
Section 12(b), 15 U. S. C. §78l(b) 8
Section 12(d), 15 U. S. C. §78l(d) 9
Section 25, 15 U. S. C. §78y 3

Rules under the Securities Exchange Act of 1934

Rule 17 C. F. R. 240. 10b-5 4
Rule 17 C. F. R. 240. 12d 2-1 9
Rule 17 C. F. R. 240. 12d 2-2(d) 9

Administrative Procedure Act §5(c), 5 U. S. C. §554 18

OTHER AUTHORITIES:

5 Wigmore on Evidence §1367 (3d ed. 1940) 14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No.

INTERCONTINENTAL INDUSTRIES, INC.,

Petitioner,

versus

AMERICAN STOCK EXCHANGE and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Petitioner, Intercontinental Industries, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on December 20, 1971.

Opinions Below

The opinion of the Court of Appeals is reported at 452 F. 2d 935 (1971) and is reprinted in Appendix A hereto. The opinion of the Securities and Exchange Commission is reprinted in Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals for the Fifth Circuit was entered on December 20, 1971. On March 9, 1972 this Court extended the time within which to file a petition for certiorari to April 25, 1972. This Court's jurisdiction is invoked under 28 U. S. C. §1254(1).

Questions Presented

1. Whether Petitioner was entitled to constitutional due process prior to having its shares delisted by the American Stock Exchange?

2. Whether the procedures followed by the American Stock Exchange in delisting Petitioner's securities for violation of disclosure policies amounted to a denial of constitutional due process, especially where such action had never before been taken by any registered securities exchange?

Constitutional Provision

Amendment V of the United States Constitution provides in pertinent part that:

> "No person shall . . . be deprived of life, liberty or property, without due process of law."

Introductory Statement

On April 3, 1970 the Securities and Exchange Commission (hereinafter called "Commission") granted an application of the American Stock Exchange (hereinafter called "Exchange") dated August 28, 1969 to strike the common stock of Intercontinental Industries, Inc. (hereinafter called "IXI"), from listing and registration. A peti-

tion for review to the Court of Appeals for the Fifth Circuit was filed on May 27, 1970 pursuant to Section 25 of the Securities and Exchange Act of 1934 (15 U. S. C. §78y). On December 20, 1971 the Court of Appeals for the Fifth Circuit entered an order affirming the order of the Commission.

Statement

On August 28th, 1969, for the first time in the history of any registered stock exchange, the Exchange filed an application with the Commission in which it sought to delist based on certain alleged violations of its disclosure policies. This is also the first time that a company's securities was sought to be delisted where the company met all the financial and other criteria for listing. The common stock of INI had been listed on the Exchange from October 12, 1961 until April 7, 1970.

On July 25, 1969, INI received a letter from the Exchange wherein it was advised that delisting of its common stock was being considered because of alleged violations of the listing agreement between INI and the Exchange and of the Exchange's disclosure policy. INI was further advised that the matter would be presented to the Board of Governors of the Exchange and that representatives of INI could, if they wished, meet with the Exchange's Committee on Securities and make a presentation of such facts as may bear on the question of continued listing. The allegations against INI were set forth in one paragraph of the July 25th letter. INI advised the Exchange that it wished the opportunity to defend itself and a meeting before the Committee was arranged for August 6, 1969.

The charges against INI stemmed from certain public announcements made by it. On April 11, 1969, INI announced that it was engaged in preliminary negotiations

to acquire 81% of the outstanding stock of an unnamed modular home builder. On April 15, 1969, IXI further announced that a preliminary memorandum of understanding concerning the acquisition of Prebuilt Homes, Inc. (hereinafter called "Prebuilt") had been entered into. A definitive contract dated May 16th, 1969, relating to such acquisition was later entered into and an announcement to that effect was made by IXI on May 20, 1969. At no time did any officer or director of IXI become an officer or director of Prebuilt nor did IXI own any shares of Prebuilt. On June 16, 1969, IXI made an announcement concerning a proposed merger with Capital Baneshares, Inc. and Central Foundry Company.

On June 19, 1969, the Exchange halted trading in the common stock of IXI. On June 26, 1969, the Commission suspended all trading in IXI stock pending the issuance by IXI of a clarifying statement concerning the facts and circumstances surrounding the above announced transactions, and on July 11, 1969, the Commission filed a compiaint in the United States District Court for the Southern District of New York seeking an injunction prohibiting violations of Section 17 of the Securities Act of 1933, 15 U.S.C. 77q(a) and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and Rule 17 CFR 240.10b-5 thereunder. On July 11, 1969, IXI and all but one of the named defendants in the injunctive action agreed to the entry of the injunction without admitting or denying the allegations contained in the complaint. In addition, on July 18, 1969, IXI released a six-page letter to its shareholders clarifying the matters referred to above. The letter was reviewed by the Exchange and modified in accordance with certain suggestions made by the Exchange prior to IXI's release of the letter to its shareholders. Subsequent to the dissemination of the information contained in that letter, the Commission terminated its trading suspension as of July 25, 1969.

On August 6th, 1969 a purported hearing was held before the Exchange's Committee on Securities at which time several persons made presentations on behalf of IXI. The Committee had been furnished with a memorandum from its staff containing certain facts along with a recommendation for delisting. IXI was not furnished with a copy of this memorandum.

At the hearing, IXI was not confronted with any witnesses or evidence. IXI was required to meet the burden of convincing the Committee that delisting should not occur.* In the course of the meeting with the Committee, IXI submitted various documentary and other written material and officers of IXI presented evidence to show that press releases were issued in reliance upon documents believed by IXI to be accurate and that it was reasonable to rely on such documents. One of the documents relied upon was a proposed offering circular prepared by Prebuilt's attorneys which IXI had every reason to believe was accurate. No transcript of the proceeding was permitted and since no witnesses appeared on behalf of the Exchange, IXI was unable to avail itself of any cross-examination.

The hearing was scheduled by the Exchange to commence late in the afternoon in order to accommodate the regular business schedule of the Committee members. The entire meeting lasted four hours, and was entirely consumed by IXI trying to defend itself against unknown accusers. The proceeding was actually controlled by the staff of the Exchange which was present at the hearing and directed numerous hostile questions at IXI representa-

* The application of the Exchange dated August 28, 1969, states at page 8, ". . . no additional facts were presented at the hearing which would warrant continued listing of the security. Therefore the Committee determined to recommend [delisting] to the Board of Governors. . . ."

tives. However, IXI representatives were not permitted to question the staff. Although the Exchange presented no evidence whatsoever at this proceeding, nevertheless, IXI received a letter on August 11, 1969, from the Chairman of the Committee on Securities wherein he stated:

> "I wish to assure you that the hearing was conducted for the purpose of ascertaining all of the relevant facts relating to this matter and that the determination by the members of the Committee concerning the recommendation to be made to the Board of Governors will be based on such facts."

The Committee then presented its recommendation to the Board of Governors. Members of the Committee who conducted the purported hearing and made the recommendation to the Board of Governors participated in the decision of the Board.

Although the Board of Governors was vested with the responsibility for determining whether the delisting application should be filed, IXI was not permitted to appear before that body despite a plea by its counsel (letter of August 28th, 1969 to Exchange). The August 28th letter of IXI's counsel also requested an opportunity to present additional witnesses and evidence but this request was denied in a written reply from the Exchange received on September 10th, 1969.

On August 28th, 1969, the Exchange filed a delisting application with the Commission. The application enumerated the charges against IXI in nineteen separate paragraphs.

At no time did IXI learn of the specific evidence relied upon by the Committee or the Board or were they given

the opportunity to cross-examine any witnesses relied on by the Exchange. For example, it is clear that the Exchange relied on material evidence adduced from an analyst interviewed by a Wall Street Journal reporter. Its delisting application dated August 28, 1969, states at page 3:

> "For example, an article appeared in the Wall Street Journal on June 3, 1969, stating that an analyst from Argus Research Corp. reported that an official of Intercontinental 'predicted Pre-built's earnings would jump from an anticipated $100,000 in the fiscal year ending July 31, 1970 to $9 million three years later' and that 'sales in the same period were forecast as due to rise to $97 million from $5.5 million.' The article further stated that, according to the analyst, in terms of consolidated earnings, 'Intercontinental predicts a meteoric rise to $10 million in the year ending July 31, 1973, from an estimated $425,000 in the current fiscal year.' This analyst was contacted by the Exchange and he advised that the information concerning projected sales and earnings of Pre-built and Intercontinental had been received from Samuel Giller, a vice president and director of Intercontinental."

At no time was INI confronted with this faceless and nameless witness and allowed the opportunity of cross-examination.

INI requested a hearing before the Commission which was later denied and the proceeding before the Commission was relegated to memoranda submitted by counsel for the parties.

Reasons for Granting the Writ

I.

The action taken by the Exchange amounted to a deprivation of substantial property rights through "governmental action" entitling INI to constitutional due process.

The power wielded by an institution such as the Exchange is enormous. Its actions affect over one thousand companies as well as millions of shareholders. Initially, stock exchanges were treated as private clubs by the courts, which refused to interfere in their affairs. *Belton* v. *Hatch*, 109 N. Y. 593, 17 N. E. 225 (1885). A gradual recognition of the enormous power and impact of national securities exchanges on the economy resulted in enactment of the Securities Exchange Act of 1934, 15 U. S. C. §78a, *et seq.* (hereinafter called the "Act") which imposed a statutory scheme of self-regulation on such exchanges. *Silver* v. *New York Stock Exchange*, 373 U. S. 341, 83 S. Ct. 1246, 25 L. Ed. 2d 736 (1963).

The merging of governmental and private functions are apparent from the close scrutiny and power exercised by the Commission over the conduct of exchanges and its members and the listing and delisting of securities thereon. Under the Act, national securities exchanges are required to register with the Commission which must find as a condition of registration that the rules of the registrant are "just and adequate to insure fair dealing." Section 6(a) of the Act, 15 U. S. C. §78f(d). An issuer may register its securities on a national securities exchange by filing an application with the exchange and the Commission containing such detailed information as may be required by rules and regulations adopted by the Commission. Section 12(b), 15 U. S. C. §781(b). Section 12(d),

15 U. S. C. §781(d) and Rule 17 C. F. R. 240. 12d 2-1 thereunder provide that an exchange may apply to the Commission to delist a security registered thereon and under Rule 17 C.F.R. 240. 12d 2-2(d) the Commission is empowered to dispose of the matter on the basis of the application unless it orders a hearing.

The substantial benefits accruing to a company whose securities are listed on a stock exchange are readily apparent including the desirability of such securities for investment because of ready liquidity. Consequently, delisting serves to deprive investors of substantial property rights as is evidenced by an invariable decline in market price of any listed security upon announcement of delisting action.

The right vs. privilege dichotomy which traditionally determined whether one deprived of substantial property rights was entitled to constitutional due process has largely been abandoned. This Court has followed the general proposition that relevant constitutional restraints limit state power to terminate an entitlement whether the entitlement is denominated a "right" or a "privilege". *Sherbert* v. *Verner*, 374 U. S. 398, 83 S. Ct. 1790, 10 L. Ed. 2d 965 (1963) (disqualification for unemployment compensation); *Slochower* v. *Board of Higher Education*, 350 U. S. 551, 76 S. Ct. 637, 100 L. Ed. 2d 692 (1956) (discharge from public employment); *Speiser* v. *Randall*, 357 U. S. 513, 78 S. Ct. 1332, 2 L. Ed. 2d 1460 (1958) (denial of tax exemption); *Goldberg* v. *Kelly*, 397 U. S. 254, 90 S. Ct. 1011, 25 L. Ed. 2d 287 (1970) (withdrawal of welfare benefits); *Bell* v. *Burson*, 402 U. S. 535, 91 S. Ct. 1586, 29 L. Ed. 2d 90 (1971) (revocation of drivers license).

Incredibly, it was the Exchange's position in the court below that IXI was not entitled to constitutional due process since the Exchange was not a governmental agency

(A. 10).* Equally astonishing was the Commission's argument that constitutional due process was not required since delisting results in "no substantial deprivation of interest . . . which would dictate a need for a hearing" (A. 10). Although appearing to disagree with the contentions of the Exchange and the Commission, the court below refused to take a positive stand on these crucial issues merely holding that its decision did not cast its "imprimatur on these arguments" (A. 10-11). The court below should have unequivocally held that the Exchange is required to afford constitutional due process. The failure to decide these issues will only serve to perpetuate the Exchange's deeply imbedded philosophy of denying constitutional due process. The harm flowing from the approach of the court below is illustrated by the position taken by the Exchange in a presently pending injunctive action in the United States District Court for the Southern District of New York. In that action, the Exchange argued that it was not required to afford constitutional due process, the language of the court below regarding constitutional due process being "clearly dictum" (see page 13 of brief submitted by the Exchange on a motion for a preliminary injunction in *Frank J. Crimmins* v. *American Stock Exchange, Inc.*, 72 Civ. 290 (S.D.N.Y.)).

A decision on these issues is important not only to INI but to the millions of shareholders who may be effected by the Exchange's actions in the future.

---

* References are to the Appendices herein.

II.

The procedure employed by the Exchange in delisting INI's securities did not conform to the standards of constitutional due process.

Absence of any Exchange due process rules

Despite the wide application of procedural due process by agencies, labor unions, clubs and other associations, it is shocking that the Exchange's Constitution and its rules expressly provide that delisting of a security may occur without affording notice or opportunity for a hearing. Article II, Section I of the Constitution states in pertinent part:

> "The Board may list . . . upon the Exchange securities . . . and may in its discretion at any time, and without notice, suspend dealings therein, or may remove the same from listing or from unlisted trading."

This provision is carried over into Section 1002 of the Exchange's rules entitled "Policies with Respect to Continued Listing". It is significant to consider the striking variance between due process safeguards afforded by the Exchange to its members as contrasted to that afforded companies whose securities are listed on the Exchange. In the event of proposed disciplinary action against members, the Exchange's Constitution expressly provides for the granting of detailed procedural due process even for the most trivial infraction. Article V of the Exchange's Constitution provides in pertinent part:

> "B. An accusation . . . shall be in writing; it shall specify the charge or charges against such member . . . with reasonable detail. . . . A copy of such charge or charges, together with a transcript of any testimony theretofore taken which the person or persons signing the charges intend to furnish to

> the Board prior to the hearing of such charge or charges shall be served upon the accused member . . . the accused member shall be permitted in person to examine and cross-examine all of the witnesses produced before the Board. . . . After hearing all the witnesses produced before the Board and after hearing the accused, if the accused desires to be heard, the Board shall determine whether or not the accused member . . . is guilty. . . ."

The courts have recognized that the according of fair procedures is of fundamental significance since substantive inquiry after the fact cannot possibly ascertain retrospectively what the outcome would have been had the procedural safeguards been afforded in the first instance. Consequently, the failure to afford procedural safeguards has often resulted in the imposition of damage liability without regard to whether association action lacked substantive basis. *Silver* v. *New York Stock Exchange*, *supra*.

The court below found the necessary elements for constitutional due process lacking in any rules of the Exchange, stating:

> "We are confronted with some difficulty in the due process argument because the Exchange rules simply do not contain any provision governing the hearing to be conducted in connection with a delisting and do not provide the necessary elements for constitutional due process" (A. 8-9).

The Exchange attempted to justify the absence of specific rules regarding procedural due process by contending that it "must make innumerable determinations concerning a variety of matters", and that "no single inflexible procedure would meet the needs of each and every situation" (A. 9). The court appeared to reject

the Exchange's argument finding it to be "particularly unconvincing in light of present day notions of fair play" (A. 9). Again, however, the court below avoided any positive ruling on this important question. In the absence of any rules setting forth procedural safeguards the Exchange created its own version of due process which INI contends was woefully inadequate.

Failure to grant a full and fair hearing

(a) In the absence of a transcript the court below was not in a position to determine what transpired at the hearing

The court below held that the only important issue to be determined was whether the Exchange did grant INI a hearing meeting all of the applicable procedural requirements (A. 11). We believe that the court erred in holding that such a hearing had been afforded INI. In the absence of a transcript and in a prevailing atmosphere where the Exchange sincerely believed that INI was not being deprived of substantial property rights, would not suffer economic injury by being delisted and was not entitled to constitutional due process we fail to see how the court below could have concluded that due process had been afforded INI.

The nature of the prejudice resulting from the absence of a transcript was succinctly described in *Lee* v. *Habib*, 424 F. 2d 891 (D. C. Cir. 1970), where the court stated:

> "There can never be effective appellate review if the reviewing court is not able to obtain a clear picture of the precise nature of the alleged errors in the court below." at p. 897.

The absence of a transcript makes it impossible to substantiate what occurred at the hearing or to determine what documents and exhibits were properly relied upon

by the Exchange's Committee on Securities and the Commission. For example, the Wall Street Journal article liberally quoted from and strongly relied upon as damaging to INI in the Exchange's delisting application and by the Commission in its decision (B. 4) were denied to be part of the record by the Exchange and the Commission in the court below. The Exchange is obviously cognizant of the importance of a transcript since its Constitution makes it mandatory in Exchange proceedings involving members.

The court below appeared to disregard the prejudice resulting from the absence of a transcript and failed to even refer to this issue in its opinion.

(b) Lack of confrontation and the opportunity of cross-examination

The Exchange produced no witnesses or presented any evidence at the hearing. In the absence of the right of confrontation and cross-examination the hearing was an empty formality. The fundamental importance of confrontation and cross-examination as a basic principle of American jurisprudence was expressed in *Greene* v. *McElroy*, 360 U. S. 474, 496 (1959), where this Court stated:

> "Certain proposals have remained relatively immutable in our jurisprudence. One of these is where governmental action seriously injures an individual, the reasonableness of the action depends on fact findings, the evidence used . . . must be disclosed to the individual so that he has an opportunity to show that it is untrue. . . . We have formalized these protections in the requirements of confrontation and cross-examination."

The importance of cross-examination was commented on by Professor Wigmore wherein he stated in his treatise, 5 *Wigmore on Evidence* (3d ed. 1940) §1367:

> "For two centuries past, the policy of the Anglo-American system of evidence has been to regard the necessity of testing by cross-examination as a vital feature of the law. The belief that no safeguard for testing the value of human statements is comparable to that furnished by cross-examination, and the conviction that no statement (unless by special exception) should be used as testimony until it has been probed and subliminated by that test, has found increasing strength in lengthening experience."

In the first place, due process requires a "meaningful" hearing. *Armstrong* v. *Manzo*, 380 U. S. 545, 552, 85 S. Ct. 1187, 1191, 14 L. Ed. 2d 62 (1965). To one who protests against the taking of his property without due process it is no answer to say that due process would have led to the same result because there was no adequate defense in the merits. *Coe* v. *Armour Fertilizer Works*, 237 U. S. 413, 424, 35 S. Ct. 625, 9 L. Ed. 2d 559 (1951). Secondly, INI was assured by the Chairman of the Exchanges Committee on Securities, the so-called hearing officer, that:

> "I wish to assure you that the hearing was conducted for the purpose of ascertaining all of the relevant facts relating to this matter and that the determination by the members of the Committee concerning the recommendation to be made to the Board of Governors will be based on such facts".

Despite this assurance from the Chairman it is clear that the decision was not based upon facts adduced at the hearing. An irreversible decision to delist had already been made prior to the hearing, as is shown by this statement contained in the delisting application filed with the Commission:

> ". . . no additional facts were presented at the hearing which would warrant continued listing of

> the security. Therefore, the Committee determined to recommend [delisting] to the Board of Governors."

The so-called hearing in this case was never meant to serve any meaningful purpose. Therefore, the Exchange did not deem itself bound by anything transpiring at the hearing. Accordingly, the Exchange felt free to cite as proven facts in its delisting application, charges which INI had not been previously apprised of in either the notice of hearing or at the hearing. For example the delisting application stated that INI had disseminated various "brochures, charts and schedules" to the public which were "inaccurate, incomplete and misleading." The delisting application also charged INI with certain misleading projections allegedly made to a securities analyst. This analyst had been interviewed by a reporter for the Wall Street Journal who then published the interview. INI had never been apprised of either charge neither had these charges been admitted to by INI in its clarifying letter to its shareholders.

A fair procedure would have required the Exchange to present and prove its case at the hearing rather than rely upon secret testimony. A fair hearing mandated cross-examination of every witness interviewed by the staff whose evidence was part of the Exchange's case and that such witnesses be seen and heard by the Committee or the Board of Governors. The type of procedure used by the Exchange was found to be violative of due process in *Greene* v. *McElroy*, *supra*, where this Court stated:

> "The Government presented no witnesses. . . . Petitioner had no opportunity to confront and question persons whose statements reflected adversely on him or to confront the Government investigators who took their statements. Moreover, it appeared

> evident that the Board itself had never questioned the investigators and had never seen those persons whose statements were the subject of their reports'' (at 479-480).

The use of secret testimony was also condemned in *Escalera* v. *New York City Housing Authority*, 425 F. 2d 853, 862 (2d Cir. 1970) where the court stated:

> ''. . . denying the . . . opportunity to confront and cross-examine persons who supplied information in the tenants folder upon which . . . action is grounded is improper.''

We believe that the court below also erred in holding that the refusal to permit cross-examination of the staff of the Exchange or its officials was justified (A. 13). INI had sought such examination to ascertain the specific charges upon which the delisting application was based since the notice only summarized such charges in one paragraph. INI also sought to determine the application of Exchange delisting policies since numerous other companies had been suspended from trading but no delisting action had ever been taken against these companies. The court below, however, upheld the denial of such examination since the Exchange's staff and its officials ''. . . were the very people making a determination, the judges so to speak, not adverse witnesses'' (A. 13). Significantly in *Jennings* v. *Mahoney*, 404 U. S. 25, 92 S. Ct. 180, 30 L. Ed. 2d 146 (1971), cited by the court below (A. 10) as authority for its decision, this Court found the hearing to be fair because the Director of Motor Vehicles appeared, testified and was cross-examined at the hearing and the investigating police officer would also have testified except for the faulty service of a subpoena. The fact that the staff acted as ''judges'' and that members of the Committee participated in the decision of the Board

of Governors is the very procedure which INI contended below was unconstitutional in that INI was not afforded an impartial tribunal. INI had previously held meetings with the very same members of the staff who were functioning as investigators and prosecutors. In addition, prior to the hearing these same staff members were secretly closeted for one hour with members of the Committee.

The court below held this procedure not to be an unconstitutional mixing of functions, stating that, "The principle is well established that due process is not violated when an administrative agency exercises both investigative and judicial functions," citing *F.T.C. v. Cinderella Career and Finishing Schools, Inc.*, 404 F. 2d 1308, 1315 (D. C. Cir. 1968). We contend that the court below misconstrued that decision as it applies to the facts in this case. In the *Cinderella* case the question was whether a prior press release by the F. T. C. might later impell F. T. C. members to attempt to vindicate themselves in a later decision on the merits in order to justify the charges to which the publicity had been given.

That decision, however, involved a narrow exception to the Administrative Procedure Act not relevant to this matter. Except in rule making that Act requires a strict separation of prosecuting and judging and investigating and judging. Although these functions may be performed within the agency they may not be performed by the same people. Under the Administrative Procedure Act, the officer who presides at the hearing may not consult any person or party on any fact in issue without notice and opportunity for all parties to participate nor may any employee engaged in investigative or prosecuting functions participate in the decisional process on an *ex parte* basis (Section 5(c), 15 U. S. C. § 554).

In *Wasson* v. *Trowbridge*, 382 F. 2d 807 (2d Cir. 1967) the plaintiff, a cadet who had been discharged from the Merchant Marine Academy challenged the impartiality of the tribunal which had awarded him the demerits leading to his expulsion. He argued that the members of the tribunal had previously participated in the investigation against him. By thus combining the functions of policeman and judge a biased panel and an unfair hearing resulted. The court agreed, stating:

> "It is too clear to require argument or citation that a fair hearing presupposes an impartial trier of fact and that prior official involvement in a case renders impartiality most difficult to maintain" at p. 811.

The court went on to state that plaintiff was further deprived of the opportunity to show that the tribunal was not impartial because of prior contact with his case, an opportunity which INI was similarly deprived of.

(c) The measure of due process was not appropriate to the nature of the case

We agree with the court below that due process should be "appropriate to the nature of the case" *Mullane* v. *Central Hanover Bank & Trust Co.* 339 U. S. 306, 313, 70 S. Ct. 652, 657, 94 L. Ed. 2d 865 (1950). We contend however, that the nature of this case warranted a full trial type hearing. A delisting application affects not one but many persons and in this case 12,000 shareholders were adversely affected. Moreover, no emergency situation existed since INI's stock had already been suspended. Certainly, these elements as well as the fact that the action to delist for failure to meet disclosure policies was the first such action taken since the Exchange was organized, entitled INI to a high standard of due process.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

BERNARD A. FEUERSTEIN,
Attorney for Petitioner,
250 Park Avenue,
New York, New York 10017.
(212) 867-6062

Of Counsel:
NATHAN M. FUCHS
IRWIN P. UNDERWEISER

APPENDIX A

Opinion of the Court of Appeals

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 29861

INTERCONTINENTAL INDUSTRIES, INC.,

Petitioner,

versus

AMERICAN STOCK EXCHANGE and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

Petition for Review from an Order of the Securities and Exchange Commission (Texas Case)

(December 20, 1971)

Before GOLDBERG, GODBOLD and RONEY, Circuit Judges.

RONEY, Circuit Judge: We are asked by Intercontinental Industries, Inc. (INI) to review an order of the Securities and Exchange Commission granting the American Stock Exchange the right to strike the common stock of INI from listing and registration on the Exchange.[1] Petitioner seeks

[1] Securities Exchange Act, §12(d), 15 U. S. C. §78 l(d); Rule 12d2-(c), 17 CFR 240.12d2-2(c).

to set the delisting order aside on the grounds that the Exchange incorrectly interpreted its own rules as to removal of a stock from listing and that both the Exchange and the Commission failed to follow fundamental concepts of due process required by the United States Constitution.[2] Finding INI's arguments to be without merit, we affirm the order of the Securities and Exchange Commission.

The Exchange's delisting application was based on its determination that INI had disseminated or permitted the dissemination of inaccurate and misleading information concerning corporate developments, thereby violating its listing agreement. This standard agreement between the Exchange and the companies listed on the Exchange requires prompt public disclosure by the listed company of any material development in its affairs and operations which might significantly affect the market for its securities or influence investment decisions.[3]

The action seeking to bar the stock from being traded on the Exchange was the culmination of a series of events which commenced administratively on June 19, 1969, when the Exchange halted the trading of common stock of INI on the Exchange, a step triggered by the unusual trading activity in the stock as a result of certain corporate announcements.[4] One week later, the Commission suspended

---

[2] Jurisdiction is based upon Section 25 of the Securities Exchange Act of 1934 (15 U. S. C. §78Y).

[3] We are told in the briefs that this is the first time that a stock has been delisted for reasons other than failure to meet the financial criteria required for listing.

[4] On April 11, 1969, the Dow Jones broad tape and the financial press carried an announcement by INI that it was negotiating to acquire 81% of an unnamed modular home builder. INI's president was quoted as stating that "the unnamed builder has about $130,000,000 in orders on hand."

all trading in the stock, pending issuance by INI of a clarifying statement concerning the facts and circumstances surrounding the previous announcements about the acquisition of Prebuilt Homes, Inc. and the purchase of stock of and merger with Capital Foundry Co., in conjunction with Capital Bancshares, Inc. On July 11, 1969, the Commission brought suit in the United States District Court for the Southern District of New York alleging a violation

---

Four days later, INI announced that it had agreed to acquire 81% of Prebuilt Homes, Inc., a "Detroit home builder" which, according to INI's president, had orders for more than 9,800 homes, including 800 for the Metropolitan Detroit Citizens Development Authority. This announcement was also carried by Dow Jones and the financial press.

On May 20, 1969, INI issued a press release stating that a definitive contract for the purchase of an 81% interest in Prebuilt had been executed. Meanwhile, Prebuilt was distributing written materials which indicated that it would have annual sales of about $141 million and earnings of about $10 million by 1973.

A Wall Street Journal article of June 3, 1969, reported a securities analyst's statement that an INI official had predicted that Prebuilt's earnings would "jump" from an anticipated $100,000 in the fiscal year ending July 31, 1970, to $9 million three years later and that INI's consolidated earnings would rise from $425,000 to $10 million in the same period.

On June 13, 1969, INI announced that it had agreed with Capital Bancshares, Inc. to purchase 43% of the outstanding stock of Central Foundry Co., and that INI and Bancshares proposed to unite the two companies with Central Foundry. Press accounts appearing on June 16 quoted INI's president as stating that he understood the management of Central Foundry was sympathetic to the proposed combination of the three companies. The announcement included *pro forma* figures for the combined companies.

The effect of these announcements on the market price of INI stock was immediate and dramatic. During the last three weeks of March and the first week of April, 1969, the stock traded approximately 7,000 shares per week, in a price range of $11 to $13. During the last week of May, volume reached 233,000 shares and on June 13 the stock traded at a high of $31.25.

of the antifraud provisions of the securities acts in disseminating false or misleading information concerning Prebuilt.[5] All the defendants, except one IXI official temporarily out of the country, without admitting or denying the allegations in the complaint, consented to entry of an injunction prohibiting any further such activities. On July 18, 1969, IXI released a letter commenting on the various matters which had been questioned by the Exchange and the Commission.[6] The Commission then terminated its

[5] Section 17 of the Securities Act of 1933, 15 U. S. C. §77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. §78j(b); and 17 CFR 240.10b-5.

[6] This letter contained the following admissions:

> (a) At the time of the April announcements Prebuilt had no plan in operation, had not produced any modular homes, had only nominal tangible assets, and had no history of operations except that two of its officials had been associated with a company which had produced some prototypes and which currently was in bankruptcy.
>
> (b) Prebuilt had no signed contracts to build modular homes. Although it had an award from the Metropolitan Detroit Citizens Development Authority, no contract has been signed.
>
> (c) The reference to $130 million of orders was based on a letter of commitment from one of Prebuilt's own officers, who could not have purchased these homes with his own resources, but had to depend upon his ability to resell them.
>
> (d) The projections of Prebuilt's earnings did not disclose that Prebuilt was bound to pay three of its officers 81% of its earnings above $5.2 million.
>
> (e) The *pro forma* figures relating to IXI, Bancshares and Central Foundry had been substantially overstated.
>
> (f) The directors of Central Foundry had received no proposal and made no commitment concerning possible merger with IXI and Bancshares.

trading suspension order thereby permitting the resumption of over-the-counter trading in IXI stock on July 25, 1969. The stock remained barred from trading on the Exchange.

On that same date the Exchange notified IXI by letter that the matter of delisting was under review and that IXI might have the opportunity for a hearing before the Exchange's Committee on Securities. On August 6, 1969, a hearing took place before that committee. The hearing lasted more than four hours, during which time IXI presented 19 witnesses. The committee then recommended delisting to the Exchange's Board of Governors. The Board agreed with this recommendation and authorized the filing of the delisting application with the Securities and Exchange Commission.

Although IXI requested a hearing before the Commission, it was refused on the ground that "no useful purpose would be served by the presentation of oral argument to us," since IXI had presented in writing no facts or issues which had not already been presented to the Exchange.

Finding that the rules of the Exchange relating to delisting had been complied with, the Commission granted the delisting of IXI's stock.

Before examining the points raised on this appeal, we make note that §25(a) of the Exchange Act, upon which the jurisdiction of this court is based, provides that "the findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." On the record before us there can be no doubt that substantial evidence supports the Commission's implicit findings that IXI was guilty of making inaccurate and misleading statements with regard to its acquisition of Prebuilt and the proposed

merger with Central Foundry Company and that these acts violated the listing agreement made by INI with the Exchange. INI makes no serious claim otherwise. Rather, it contends that its stock should not have been delisted because after its failure to comply with disclosure requirements it took prompt corrective action, which should prevent removal from listing under the rules of the Exchange. In any event, INI contends that it never was given a full and fair hearing prior to the decision of the Exchange, first, and the Commission, later, that it deserved delisting.

I.

We deal first with the narrow question posed by INI in its brief as to whether the Commission was justified in holding that the Exchange correctly interpreted its own rule permitting delisting for noncompliance with disclosure requirements. This rule allows the Exchange to cause "suspension from dealings, and, unless prompt corrective action is taken, removal from listing."[7] INI contends that it took prompt corrective action following the suspension of its securities from trading, so that delisting is foreclosed.

Even assuming, without deciding, that there could be a situation where prompt corrective action would, as a matter of law, protect a stock from being delisted, such is not the case here. There is substantial evidence to support the Exchange's contention that INI did not take such prompt corrective action.

It is apparent that INI did not make full disclosure of the facts until required to do so by the Exchange and the Commission. The first of the misleading and incomplete

[7] American Stock Exchange Company Guide, §1003.4.

announcements was made in mid-April, 1969, and they continued into May and June. Nothing has been indicated in the record, briefs or oral argument that any action was taken until, as INI says in its own brief, it "was bludgeoned into issuing the clarifying letter in order to have its suspension lifted." This came only after all trading in the stock had been halted and a suit for injunction had been brought. We do not deem it unreasonable for the Exchange to determine that this was not the prompt action required by both the letter of the rule and the spirit of the listing agreement. The requirement of full disclosure of all corporate information which might influence investment decisions is the very heart of the federal securities regulations. *S.E.C.* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 858, 859 (2d Cir. 1968), cert. den. *sub nom. Kline* v. *S.E.C.*, 394 U. S. 976 (1969). The Exchange imposed upon INI a full measure of responsibility in this regard by obtaining a listing agreement which provides that:

> "The Corporation will make prompt public disclosure of any material development in its affairs and operations, whether favorable or unfavorable, which might significantly affect the market for its securities or influence investment decisions."

This requirement is further clarified in the agreement as follows:

> "It is expected that such statements will be factual and that judgment and restraint will be used in not publicizing information which may be construed as overoptimistic, slanted or promotional—such as estimates and forecasts not warranted by existing circumstances, premature statements of mergers or acquisitions or descriptions of new products still in

> the experimental stage, the commercial feasibility of which is problematical, etc."

Under the terms of this agreement, it is readily apparent that INI had a duty to correct any publicized misinformation about its corporation promptly when such disclosure is needed to make sure of a fully and accurately informed public, not when caught supplying faulty information. In keeping with the Congressional purpose of making the Exchange a self-regulatory body,[8] broad latitude must be given to the Exchange in making the critical judgment of when a company has failed to fulfill its responsibilities to such an extent that dealing on the Exchange in the security is unwarranted. INI argues that in every other instance where delisting was sought by the Exchange a violation of precise and established standards was charged, but that here no established standard exists concerning the meaning of "prompt corrective action." Since these are the rules of the Exchange, it should be allowed broad discretion in the determination of their meaning and application. We find no error in the Commission's approval of an interpretation of the rule which finds the acts of INI to be outside of the meaning of "prompt corrective action."

II.

The broad thrust of INI's appeal is directed at the procedure followed by the Commission and the Exchange in delisting INI's stock INI contends that it was denied the full and fair hearing demanded by the due process clause of the Constitution. We are confronted with some difficulty

[8] See *Silver* v. *NYSE*, 373 U. S. 341, 352-353 (1963).

in the due process argument because the Exchange rules simply do not contain any provision governing the hearing to be conducted in connection with a delisting and do not provide the necessary elements for constitutional due process. The argument of the Exchange that it has no specific rules because it "must make innumerable determinations concerning a variety of matters" and that "no single, inflexible procedure would meet the needs of each and every situation" is particularly unconvincing in the light of present day notions of fair play.

Likewise, the Exchange's position that constitutional due process is not required since the Exchange is not a governmental agency is clearly contrary to numerous court decisions. See *Burton* v. *Wilmington Parking Authority*, 365 U. S. 715 (1961); *Colon* v. *Tompkins Square Neighbors, Inc.*, 294 F. Supp. 134 (S. D. N. Y. 1968); *McQueen* v. *Druken*, 438 F. 2d 781 (1st Cir. 1971). The intimate involvement of the Exchange with the Securities and Exchange Commission brings it within the purview of the Fifth Amendment controls over governmental due process.[9]

There is no merit to the Commission's argument that "the action by the Exchange and the order delisting INI's stock do not involve any impairment of substantial 'rights' or

---

[9] 1. The Exchange must register with the Commission. (Section 12(b), 15 U. S. C. §781(b))

2. The Exchange's rules must be approved by the Commission. (Section 6(a), 15 U. S. C. §78f(d))

3. The Exchange's members must register with and are closely regulated by the Commission. (Section 15A, 15 U. S. C. §78o)

4. Delisting must be approved by the Commission. (Section 12(d), 15 U. S. C. §781(d))

5. The Exchange may be suspended or its registration withdrawn by the Commission. (Section 19(a)(1), 15 U. S. C. §78(a)(1))

result in serious 'economic injury or deprivation'" and that "since delisting does not affect a company's business operations or deprive a company or its stockholders of the right to sell or purchase its stock in other markets, no substantial deprivation of interest is presented here which would dictate a need for a hearing."

However, rather than decide those points here, we merely make it clear that our decision does not cast our imprimatur on these arguments or the Exchange's lack of rules, or the Commission's failure to require proper rules. The important thing to be determined in this litigation is whether the Exchange did grant INI a hearing meeting all the applicable procedural requirements. *Jennings* v. *Mahoney*, —— U. S. —— (1971) [40 LW 3216, Nov. 9, 1971].

Specifically, INI complains of (a) lack of adequate notice, (b) lack of confrontation and cross-examination of witnesses, (c) improper mixing of the functions of the Exchange's Committee on Securities, (d) failure of the Exchange's Board of Governors to permit INI to appear before it, and (e) failure of the Commission to hold a hearing. We shall deal with petitioner's contentions *seriatim*.

(a) *Notice*. The right to a fair hearing in an administrative proceeding embraces "a reasonable opportunity to know the claims of the opposing party and to meet them." *Morgan* v. *United States*, 304 U. S. 1, 18 (1938). Where the notice given to the responding party is not misleading and apprises that party of the issues in controversy, the requirements of the law are met. *Cella* v. *United States*, 208 F. 2d 783 (7th Cir. 1953), cert. den., 347 U. S. 1016 (1954); *L. G. Balfour Co.* v. *F. T. C.*, 442 F. 2d 1 (7th Cir. 1971).

The written notice provided in this case was a four page letter from the Exchange to INI's president. When read with "due regard for the practicalities and peculiarities of the case," *Mullane* v. *Central Hanover Bank and Trust Co.*, 339 U. S. 306, 314 (1950), this letter satisfied constitutional demands. The letter informed INI that the Exchange was considering delisting INI's stock, that this action was being contemplated because of the misleading information which had been disseminated about INI, Prebuilt and Central Foundry, and that INI would be given a hearing before the Exchange's Committee on Securities.

Before this letter was sent, trading in INI's stock had been suspended for six weeks, the Commission had filed a lawsuit in which a consent decree had been entered against INI, INI's president had sent a letter to stockholders outlining the exact nature of the inaccurate statements the company had made and Exchange officials had held numerous meetings with INI in which the company's noncompliance with disclosure requirements was explored. All of this activity involved the same facts and concerns as the hearing and the pending action by the Exchange. The notice under such circumstances need not be composed with the precision of a criminal indictment. *Woodbury* v. *McKinnon*, —— F. 2d —— (5th Cir. 1971) [No. 30420, July 12, 1971].

(b) *Confrontation and Cross-Examination.* On August 6, 1969, the Exchange's Committee on Securities held a four hour hearing, during which INI presented nineteen witnesses. It is INI's contention in this court that it should also have been allowed to cross-examine the members of the Exchange staff who prepared a report for the Committee on Securities, and to confront an unnamed securities analyst who purported to be the source of the inaccurate information appearing in the Wall Street Journal article of June

3rd (see fn. 4). We think that IXI's arguments on this point misconceive the nature of the proceeding against it.

Virtually all of the material facts had been admitted by IXI in its letter to the stockholders on July 18 and are not really disputed by IXI now. In fact, IXI can hardly do so because if the facts in that letter are incorrect, then the letter itself, uncorrected, becomes a violation of the requirement of full disclosure. With no dispute as to the material facts, it does not appear that there were issues in the case which required cross-examination. Compare *Goldberg* v. *Kelly*, 397 U. S. 254 (1970). This court has expressly rejected the notion that a "full dress hearing with the right to cross-examine witnesses" is required in every case. *Dixon* v. *Alabama State Board of Education*, 294 F. 2d 150, 159 (5th Cir. 1961); *Wright* v. *Texas Southern University*, 392 F. 2d 728 (5th Cir. 1968). There is no reason why IXI should have been permitted to examine officials of the Exchange or its staff at the meeting. These were the people making a determination, the judges so to speak, not adverse witnesses. *San Francisco Mining Exchange* v. *Securities and Exchange Commission*, 378 F. 2d 162 (9th Cir. 1967); *Woodbury* v. *McKinnon*, *supra*.

The issue as to the Wall Street Journal article was not whether its sources were trustworthy, but what, if anything, IXI did to correct the admittedly misleading information there published. There was no dispute as to the publication. IXI's president was aware of the publication, should have known of its probable impact on trading activity, had access to ready verification of the information and apparently did no more to undo its harmful effects than to make the mild disclaimer that "These estimates are not coming from our management—nor me." The question for decision was whether more was required. This question did not turn on

the source of the inaccurate information which INI sought to reveal by cross-examination.

(c) *Mixing of Functions.* INI argues that there was a due process violation when the Exchange's Committee on Securities first conducted the August 6th hearing and then sat with the Board of Governors while the entire Board considered whether or not to file a delisting application. This, in INI's view, amounted to an unconstitutional mixing of the functions of prosecutor, judge and jury in the same body. The principle is well established, however, that due process is not violated when an administrative agency exercises both investigative and judicial functions. *F.T.C. v. Cinderella Career and Finishing Schools, Inc.*, 404 F. 2d 1308, 1315 (D. C. Cir. 1968).

(d) and (e) *Hearing Before the Board of Governors and Commission.* INI's final argument is that it was denied due process because it was not permitted to appear and present evidence before the Exchange's Board of Governors or the Securities and Exchange Commission. INI admits in its brief, however, that constitutional requirements are satisfied if a full hearing is held at some stage of the proceeding prior to final adjudication. *Nickey* v. *Mississippi*, 292 U. S. 393 (1934); *Rowan* v. *Post Office Dept.*, 397 U. S. 728 (1970). Having had a full hearing before the Exchange's Committee on Securities, INI had no constitutional right to a second hearing before the Board of Governors, or the Commission.

There is no statutory requirement that the Commission hold a hearing before granting a delisting application. Under §12(d) of the Securities Exchange Act, 15 U. S. C. §78 1(d), and the Commission's rules promulgated thereunder, 17 CFR §240.12d2-2(c), the Commission "may"

order a hearing on a delisting application. Thus, in the circumstances of this case, and in the absence of a showing that petitioner had new evidence to present to the Commission, see *American Export & Isbrandtsen Lines v. Federal Maritime Commission*, 334 F. 2d 185 (9th Cir. 1964), we cannot say that it was error for the Commission to decline to grant IXI a hearing.

The order of the Securities and Exchange Commission is Affirmed.

APPENDIX B

Opinion and Order, Dated April 3, 1970

(FINDINGS, OPINION AND ORDER, GRANTING APPLICATION TO STRIKE SECURITY FROM LISTING AND REGISTRATION)

(Securities Exchange Act Release No. 8858)

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

April 3, 1970

In the Matter of

INTERNATIONAL INDUSTRIES, INC.
Dallas, Texas
File No. 1-5566
Securities Exchange Act of 1934
Section 12(d)

STRIKING OF SECURITY FROM LISTING AND REGISTRATION

Failure to Comply with Listing Agreement

Where issuer, in contravention of disclosure requirements included in its listing agreement with securities exchange, disseminated or permitted dissemination of inaccurate or misleading information concerning, among other things, the extent of orders for product of company which issuer had contracted to acquire and such company's projected sales and earnings, and issuer failed to take prompt action to correct and clarify such information, application by exchange, based on its delisting rules, to

strike common stock of issuer from listing and registration, *granted.*

Appearances:

BERNARD H. MAAS, Vice-President, for American Stock Exchange.

BERNARD A. FEUERSTEIN and IRWIN P. UNDERWEISER, of Feuerstein & Underweiser, for Intercontinental Industries, Inc.

The American Stock Exchange has filed an application, pursuant to Section 12(d) of the Securities Exchange Act of 1934 ("Act") and Rule 12d2-2(c) thereunder, to strike from listing and registration on the Exchange the common stock, $1 par value, of Intercontinental Industries, Inc. ("IXI").[1] The stock has not been traded on the Exchange since June 19, 1969, when the Exchange halted trading. IXI filed a memorandum in opposition to the application, the Exchange filed a reply and IXI submitted a rebuttal memorandum and subsequently a letter presenting further argument.

The application is based on the Exchange's determination that IXI disseminated or permitted the dissemination of inaccurate or misleading information concerning corporate developments. The Exchange's policy respecting delisting states that the Exchange will consider removing a security from listing when, in its opinion, "any . . . event shall occur or any condition shall exist which makes further dealings on the Exchange in the security unwar-

---

[1] Section 12(d) of the Act and Rule 12d2-2(c) provide in pertinent part that upon application by a national securities exchange, a security registered with such exchange may be delisted in accordance with the rules of the exchange upon such terms as we may deem necessary to impose for the protection of investors.

ranted,"[2] and guidelines, adopted to assist in the application of the Exchange's policies, specify among other things that securities of a company which fails to comply with its listing agreement with the Exchange in any material respect "are subject to suspension from dealings and, unless prompt corrective action is taken, removal from listing," and that delisting will be considered if a company or its management engage in operations which, in the opinion of the Exchange, are contrary to the public interest.[3]

The application states that INI and its management disseminated or permitted the dissemination of inaccurate, incomplete or misleading information concerning material developments in its affairs and operations. In so doing, it is alleged, they failed to comply with a provision of the listing agreement with the Exchange requiring prompt public disclosure by a listed company of any material development in its affairs and operations which might significantly affect the market for its securities or influence investment decisions. The application further states that the activities of INI and its management in these respects were contrary to the public interest and violated the Exchange's requirements for continued listing.

There is no substantial dispute as to the nature of the information which was disseminated or as to the fact that such information was misleading in material respects. As recited in the Exchange's application, on April 11, 1969 INI preliminary agreed to purchase 81% of the outstanding stock of Prebuilt Homes, Inc. ("Prebuilt"), a company that had been organized in March 1969 to produce and sell factory-built modular homes, from Prebuilt's

---

[2] American Stock Exchange Company Guide, §1002.

[3] *Id.*, §1003.

three stockholders; on the same day IXI announced that it proposed to acquire 81% of the stock of a modular home builder, which it did not then name, that had orders of about $130 million on hand; and in an announcement a few days later IXI identified Prebuilt and stated that Prebuilt had orders to build more than 9,800 homes, including 800 pre-finished modular homes for the Metropolitan Detroit Citizens Development Authority ("MDCDA"). On May 20, 1969, IXI reported the execution of a definitive contract of purchase of the Prebuilt stock.

Following the above announcements written material prepared by Prebuilt was distributed to persons in the securities industry and others which indicated that as of April 1, 1969 Prebuilt had orders and proposals on hand for 9,039 housing units, amounting to a sales volume of over $116 million. The material projected annual sales of about $141 million and net earnings of about $10 million by 1973 and cumulative sales and earnings for the five-year period 1969-1973 of approximately $392 million and $29 million, respectively. The Wall Street Journal of June 3, 1969 reported a securities analyst's statement that an IXI official had predicted Prebuilt's earnings would "jump" from an anticipated $100,000 in the fiscal year ending July 31, 1970 to $9 million three years later and sales would rise from $5.5 million to $97 million in the same period, and there would be a "meteoric" rise in IXI's consolidated earnings from an estimated $425,000 in the current fiscal year to $10 million in the year ending July 31, 1973. The Exchange's application states that the analyst subsequently advised the Exchange that these projections had been received from a named vice-president and director of IXI.

The application recites that when the above information was disseminated, certain material facts, including the following, were not disclosed: At the time of the April announcements, Prebuilt had only nominal tangible assets, had not commercially produced any modular homes, had no plant in operation in which modular homes could be manufactured [4] and had no previous history of operations or earnings. Prebuilt had no signed contracts to build modular home units and few, if any, firm commitments for the purchase of such units. Although it had received an award from MDCDA to build 800 units, no contract had yet been entered into.[5] The remainder of the purported orders for 9,800 homes consisted of letters of intent or proposals in various stages of planning which were not legally binding.[6] These included a proposed project of 4,500 homes to be built by a joint venture in which the three stockholders of Prebuilt would be participants. The success of this project was contingent on the availability of land, financing and resaleability of the homes. The reference to $130 million of orders was based primarily on a letter of commitment from Lester Taubman, Prebuilt's president, in which he agreed to purchase 9,039 units from Prebuilt prior to June 1972, less such units as might be sold to MDCDA or any other organization or as might be erected by Prebuilt in connection with its own land development programs. While

[4] During April Prebuilt was engaged in negotiating a lease for a 120,000-square foot building and on May 1, 1969 it took possession under a five-year lease.

[5] The application states that at a hearing before an Exchange committee on August 6, 1969, officials of IXI and Prebuilt indicated that this contract was still being negotiated and that no other contracts had yet been executed.

[6] IXI advised its shareholders in July 1969 that several of the original proposals covering a substantial number of the 9,800 housing units were subsequently withdrawn or terminated.

Taubman's commitment could exceed $100 million, his net worth was such that his ability to purchase units pursuant to the commitment was dependent on his ability to resell the units.

In connection with the earnings projections for Prebuilt, it was not disclosed that under employment contracts between Prebuilt and its three principals, the latter would receive as supplemental compensation an amount equal to 81% of Prebuilt's net income in excess of $5,225,000 for the five-year period ending July 31, 1974. This amount was to be paid annually, beginning in September 1974, out of 40% of pre-tax net profits for the fiscal year ending July 31, 1974 and subsequent fiscal years until paid in full.

On June 13, 1969, INI announced that it had joined with Capital Baneshares, Inc. (which is controlled by INI's president) to purchase 4.3% of the outstanding stock of Central Foundry Company from Central's president for $1 million and that INI and Baneshares intended to propo uniting the two companies with Central. The announcement included *pro forma* figures for the three companies combined. Press accounts quoted INI's president as stating that he understood the management of Central was sympathetic to a proposal for combining the three companies. However, according to a letter sent by INI to its shareholders on July 18, 1969, following the halt in trading, the *pro forma* figures, especially for net income, were substantially overstated; INI had submitted no proposal for merger or unification of the three companies to Central's directors; and INI had received no formal commitment, written or oral, from any director of Central indicating that he favored such action.

The application states that the information disseminated regarding Prebuilt and INI had a significant effect on the

market for INI stock between April 11, 1969, when the first announcement was made, and June 19, 1969, when Exchange trading was stopped, with both volume and price rising sharply during that period.[7] On June 26, we suspended all trading in INI stock. We then brought an injunction action against INI, Prebuilt and certain of their officers and directors, alleging that they violated antifraud provisions of the securities acts in the dissemination of false or misleading information concerning Prebuilt, and a consent decree was entered on July 15, enjoining statements of the nature described in the complaint. Following INI's information letter to its shareholders of July 18 regarding the matters discussed above and other matters, we terminated our suspension order, thereby permitting resumption of over-the-counter trading in INI stock.[8]

INI urges that we should deny the application and permit resumption of Exchange trading in its stock. It argues that the delisting guidelines relied on by the Exchange permit removal from listing only if following a suspension of trading prompt corrective action is not taken, and it points to instances of suspensions based on misrepresentations where the Exchange permitted resumption of trading after corrective action had been taken. It asserts that it took corrective action, in the form of the July 18 shareholder letter, as soon as it could legally do so following the sus-

---

[7] During the last three weeks of March and the first week of April, average weekly volume was about 7,000 shares and the price ranged from 11⅛ to 13. On April 11, 18,600 shares were traded and the stock closed at 15½ up 1½. In the ensuing weeks, weekly volume ranged from 15,400 to 233,300, and the price from 14¼ to 31¼, the closing price prior to the halt in trading being 26½.

[8] In the first week of such over-the-counter trading the bid quotations for INI stock ranged from 5⅝ to 7½ and the ask quotations from 6½ to 9½.

pension. It further argues that the Exchange's rules should be construed to permit delisting only where there has been a continuous pattern of misrepresentations amounting to willful fraud, which it asserts was not the case here. It also stresses that unlike the situation in other delisting cases, it meets all criteria for listing.

In our opinion, IXI's arguments do not present a basis for disturbing the Exchange's determination that the Company's stock should be delisted. One of the stated purposes of the Act is to "insure the maintenance of fair and honest markets in [securities] transactions."[9] It is essential to the maintenance of such markets that companies whose securities are held by the public refrain from publishing inaccurate and misleading information of a material nature.[10] It seems clear, moreover, that an exchange has an obligation, in the exercise of its self-regulatory responsibilities, to assure, as far as is possible, that the issuers of securities traded on it make prompt and accurate disclosure of material corporate developments.[11] Pursuant to this obligation the Exchange has among other things adopted a policy requiring the prompt public disclosure of material corporate developments, which by its very nature embodies a requirement that such disclosure be accurate,

[9] Section 2.

[10] See *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858 (C. A. 2, 1968), *cert. den.* 394 U. S. 976 (1969).

[11] Under Section 6(d) of the Act, an exchange, in order to obtain registration, must have rules which are "adequate to insure fair dealing and to protect investors." Section 19(a)(1) of the Act authorizes us to suspend or withdraw the registration of an exchange which has failed to enforce, as far as is within its power, compliance with the provisions of the Act or the rules thereunder by an insurer of a security registered thereon.

and has incorporated such policy into its listing agreements. The listing agreement further specifies that,

> "It is expected that [corporate news releases] will be factual and that judgment and restraint will be used in not publicizing information which may be construed as overoptimistic, slanted or promotional —such as estimates and forecasts not warranted by existing circumstances, premature statements of mergers or acquisitions or descriptions of new products still in the experimental stage, the commercial feasibility of which is problematical, etc."

While as stated IXI questions the appropriateness of delisting as a remedy for misleading corporate publicity where standards for continued listing are otherwise met, it seems clear that an exchange should be permitted to cleanse itself of the securities of issuers which act in clear disregard of its disclosure requirements. Although delisting may have adverse effects on present investors, in our opinion the Exchange may reasonably consider such effects to be outweighed by the interests of possible future investors where the issuer has evidenced an unreliability with respect to important disclosures. Of course the Exchange's action must conform to its rules. The Exchange contends, and we agree, that IXI did not take such "prompt corrective action" as would preclude delisting under its rules. It is apparent that IXI did not make full disclosure of the facts until forced into doing so by the Exchange and this Commission. As noted, in mid-April 1969, IXI made a series of announcements concerning Prebuilt which contained misstatements and omissions of a most serious nature. During a period of more than two months thereafter, until trading was halted by the Exchange, no attempt

was made to correct or clarify these announcements despite a marked increase in the price of, and volume of trading in, INI stock and inquiries by the Exchange as to the cause of such increase.[12] And, as noted, further misleading statements were made in connection with the Central Foundry transaction. We cannot find unreasonable the Exchange's interpretation of its rules as requiring that the issuer take corrective action promptly after its non-compliance with the disclosure requirements, and not merely, as contended by INI, promptly after the Exchange has had to resort to a suspension of trading.

INI refers to evidence it presented at a hearing held before a committee of the Exchange in August 1969 which it claims showed that its press releases were issued in reliance on documents it believed to be accurate, including a proposed offering circular prepared by Prebuilt's attorneys. However, it seems clear, particularly in view of the extravagant nature of the claims being made for Prebuilt, a newly organized company, that a diligent investigation should have been made to ascertain the true facts before disseminating information to the public. The information in question was by its nature readily subject to verification. Moreover, instead of correcting the infor-

[12] The Exchange states, and INI does not dispute, that during this period Exchange representatives contacted INI officials on a number of occasions to determine whether there were any developments which might account for the increased activity, but nothing was disclosed by INI suggesting that the announcement concerning Prebuilt may have been inaccurate or misleading. The Exchange further states that on June 4, 1969, INI's president and vice-president were cautioned by Exchange officials with respect to their responsibilities to insure fair and accurate disclosure in view of the optimistic projections and estimates being published about INI and Prebuilt.

mation released in April, further misleading information was disseminated by Prebuilt and by a vice-president of IXI.[13]

It is not a basis for denying the application that, as asserted by IXI, no question had been raised concerning press releases issued by it prior to those under consideration or that, despite the price rise, none of its officers and directors sold IXI stock subsequent to April 11, when the first announcement concerning Prebuilt was made. Nor do we consider that the Exchange was precluded from taking delisting action here because in other cases it has

[13] IXI asserts that there is no evidence that any of the Prebuilt releases were distributed by persons authorized to do so by IXI, that the statements attributed to the IXI vice-president are based on hearsay and that the Exchange has not offered evidence as to whether he was actually interviewed by the securities analyst mentioned in the Wall Street Journal article of June 3 and, if so, whether he was accurately quoted. However, we agree with the Exchange that IXI, having publicized the agreement to purchase a majority interest in Prebuilt, had a duty to assure the accuracy of material information thereafter disseminated by that company, which would necessarily affect the market for IXI stock; at the least it had a duty to correct promptly any inaccuracies. IXI has not denied that its vice-president made the statements attributed to him. IXI points out that in the same Wall Street Journal Article a statement is attributed to its president that "these estimates" (apparently referring to the earnings estimates for Prebuilt) were not coming from IXI's management, or from him. But, according to the article, when asked how he could permit the management of a subsidiary to make earnings projections that might encourage investor activity, he responded that he was "not going to tell Prebuilt not to be enthusiastic. We're pleased with their enthusiasm."; that it was a "remote possibility" that the projections could be met; and that the figures "should not be disseminated until we have a longer experience factor." Thus, the article demonstrates at the least an awareness in June 1969 by IXI's management of the nature of the information being disseminated by Prebuilt.

permitted trading to resume when, following a suspension of trading because of misrepresentation, corrective action had been taken. IXI points in particular to action by the Exchange in December 1969 permitting the resumption of trading in a named security following clarification of certain public statements. However, no two cases are the same, and we think the Exchange must be accorded a reasonable discretion in determining the nature of the action which is appropriate in a particular case.[14]

IXI further contends that the Exchange failed to accord it a full and fair hearing and thereby denied it due process. Its principal argument in this respect is that it was not provided with proper notice of the charges against it in advance of the hearing before the Exchange committee in August 1969 and was therefore unable to prepare a defense. The record before us shows, however, that IXI had ample notice of such charges. Following the halt of trading on June 19, Exchange officials had numerous meetings with IXI in which the company's noncompliance with disclosure requirements was explored. The essential facts subsequently recited in the delisting application were alleged in our injunctive complaint of July 11. IXI's shareholder letter of July 18 referred to the information which had been disseminated by IXI and Prebuilt and corrected and clarified such information. By letter of July 25, 1969, the Exchange advised IXI that the question of continued listing of its stock was under consideration. The letter referred to the pertinent delisting policy and guidelines and to the dissemination by officers and direc-

[14] *Cf. Fotochrome, Inc.*, Securities Exchange Act Release No. 7985 (October 24, 1966), *reh. den.*, Securities Exchange Act Release No. 8013 (December 29, 1966).

iors of IXI and Prebuilt of statements concerning Prebuilt's sales and orders and projected sales and earnings, IXI's acquisition of an interest in Central Foundry and the possibility of its uniting with that company and Capital Baneshares, and *pro forma* figures for the three companies combined. It stated that in the absence of a satisfactory explanation for the misleading and inaccurate information disseminated, consideration had to be given to the question of continued listing and that IXI would be given an opportunity for a hearing before the Committee on Securities before the matter was presented to the Board of Governors. At the hearing before the committee, representatives of IXI, Prebuilt and other interested organizations made a presentation, following which the committee concluded, and the Exchange's Board of Governors concurred, that delisting should be sought.

IXI's other procedural arguments are equally without merit. There is no reason why IXI should have been permitted to examine officials of the Exchange at the hearing. Its claim that the Exchange did not permit a transcript of the hearing to be made is denied by the Exchange which states that IXI's counsel declined an offer by the Exchange to provide a reporter; in any event, IXI has not shown that it was prejudiced by the absence of a transcript. There is also no basis for the contentions that the Exchange should have introduced evidence in support of its charges and that the committee which conducted the hearing and which is composed of members of the Board of Governors was not an impartial fact-finder.

We conclude that it is appropriate to grant the Exchange's application. We are also of the view that no useful purpose would be served by the presentation of oral argument to us, as requested by IXI.

Accordingly, IT IS ORDERED that the application of the American Stock Exchange to strike from listing and registration the common stock of Intercontinental Industries, Inc., be, and it hereby is, granted, effective at the opening of trading on April 7, 1970.

By the Commission (Chairman BUDGE and Commissioners OWENS, SMITH, NEEDHAM and HERLONG).

Orval L. DuBois
ORVAL L. DUBOIS
Secretary